

CIA/ONE/STAFF MEM/20-65 FOREIGN AID PROBLEMS IN S. ASIA

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CENTRAL INTELLIGENCE AGENCY

OFFICE OF NATIONAL ESTIMATES

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STAFF MEMORANDUM NO. 20-65: (Internal ONE Working Paper
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SUBJECT: Foreign Aid Problems in South Asia

SUMMARY

India, Afghanistan and Ceylon face financial difficulties, and their leaders think they can solve their problems with increased external economic assistance from the US. One has already requested such aid, and the other two will probably follow in short order. These requests came at a time when political pressure in the West is building up for a slash in foreign aid -- a fact of which the leaders of none of these countries appears aware. Rather, they tend to view external assistance -- on an increasing scale -- as something to be taken for granted. All three will continue to have a real need for some external assistance. Failure to receive larger amounts of aid would increase anti-Western feelings, but is not likely in the near future to lead to major political or economic crises.

State Dept. review completed

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India

1. India's foreign aid needs are becoming astronomical.

It is already the single largest recipient of US assistance in the world. It receives \$500 million a year in economic aid, and in 1964, PL-480 wheat shipments reached the level of six million tons, some 15-20 percent of the annual US wheat crop.* Given India's growing population (now over 470 million people) and continuing difficulties in increasing food production, the present level of PL-480 shipments will probably have to be maintained or even increased somewhat for several years to prevent further food crises. Indeed, our embassy in New Delhi has recommended that these shipments be increased by one million tons for each of the next two years.

2. Two factors make an Indian request for a major aid increase likely. Most of the assistance supplied by Western countries, recently amounting to over a billion dollars a year, has been in the form of loans, and the schedule of debt and interest repayments is rising rapidly. During India's scheduled Fourth Five Year Plan (to begin in April 1966), total foreign

* India also receives substantial US military assistance, both as loans and grants, of some \$100 million a year. This military aid is not considered here.

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debt servicing will rise to about \$2.5 billion, or an average of \$500 million dollars annually. Further, there are a number of indications that New Delhi wants to receive foreign aid closer to the per capita magnitude of that given to Pakistan in recent years, in the hope of accelerating India's three-six percent rate of growth to something like the five-six percent achieved by Karachi. Were total external assistance to India to rise to that level,^{*} India would receive a total of nearly \$13 billion plus substantial food grains shipments for the five year period 1966-1971.

* The head of the Indian Planning Commission has recently stated that India's Fourth Plan foreign aid needs must be revised upwards from its October 1964 estimate of \$6.7 billion. In late April 1965, the Commission said it would probably need at least \$7.8 billion for this period, an average of over \$1.5 billion per year. In April 1965 our Embassy in Delhi stated that India's exchange requirements, aside from PL 480 shipments and export earnings, will be about \$9.5 billion dollars in the Fourth Plan. The Embassy believes that about \$2 billion can be obtained from private investors and sources other than the Consortium. (primarily the USSR) This would leave needs of nearly \$7.5 billion, or \$1.5 billion a year -- of which the US would pay at least half. US Embassy is probably somewhat unrealistic, since India's ability to attract such a high level of private investment in the near future is questionable. At present, there is a small net outflow of private exchange resources. While the situation will probably improve, India is unlikely to receive more than a hundred million a year in net private investment. Further more, debt servicing charges will be larger than those cited. However, Soviet aid will increase.

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3. India's actual aid request (which will be made later in 1965) will probably be based on a balance between what New Delhi thinks it will need and what it thinks it can get. While some of its leaders recognize the difficulty of getting more external assistance, Indian ignorance of increased donor resistance to even present aid levels is widespread and Indian capacity for self deception is considerable. The Shastri government is likely to ask the Aid-to-India Consortium for a combination of debt postponements and increased financial assistance amounting to between \$1.5 to \$2 billion a year or \$7.5 to \$10 billion during the plan period. The request will be justified by pointing out both India's urgent needs and its importance to the West.

4. Soviet aid, which India is now utilizing at the rate of about \$200 million a year, will increase. Shastri's Moscow visit in May 1965 led to a new agreement which will probably permit New Delhi to draw down about \$250 - \$300 million annually from the USSR and Eastern Europe. This amount is not likely to be raised again in the next few years. Most West European countries are showing considerable reluctance to enlarge their Indian aid programs -- an attitude we think will continue. This would

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the
leave only/US, which may be asked to pay up to double its present \$500 million a year program. Many Indian leaders appear unaware that such a jump would be viewed with little enthusiasm by the American Congress, Which has just authorized an aid program for FY 1966 of \$2.3 billion in economic assistance for the entire underdeveloped world.

5. India's unsatisfactory growth rate of the last few years has not resulted exclusively from too little external assistance, though shortages of imported materials have played a part. However, India's economic advance has been retarded by a variety of factors: planning failures, overemphasis on industrialization, the government's inefficient public sector projects, its penalizing of the more vigorous and creative private sector, its incompetent bureaucracy, its excessive regulation of economic life, and its discouragement of private foreign investment. If New Delhi were simply provided with increased foreign aid, it would persist in following the same policies that have led to the present difficulties. However, the offer of more aid -- on condition that major reforms be made in Indian economic practices -- would probably bring about at least some economic liberalization and the release of repressed energies of the private sector so long desired by

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Western economists. In particular, the offer of increased non-project aid advanced on the stipulation that it be used largely by the private sector would stimulate the Indian economy.

6. Under these circumstances, India's rate of economic growth would probably be somewhere between four-five percent a year, but in the absence of a dramatic breakthrough in agriculture, the growth rate would be unlikely to approach the six-seven percent the planners are aiming at. If foreign aid to India continues at about present levels, and no significant debt postponements are granted, India's planners will probably be forced to cut back their goals. In this situation, we believe that India's rate of growth would continue at the present rate. Public dissatisfaction would increase, and over the long term, the Shastri government would be weakened. However, its tenure, and control of the Indian political scene would probably not be threatened for some time.

Afghanistan

7. Afghanistan's problems are less serious than those of India, and its needs are comparatively small. It is not rich in resources, but neither is it saddled with a large, rapidly growing population. Its economic well being is dependent on trade with, and assistance from, both Western and Eastern powers.

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Relations with the latter have been generally satisfactory. It continues to utilize about \$50 million worth of Soviet grants and loans annually (about double that received from Western sources.) Though the USSR has become the Afghan's chief benefactor and trade partner, it has not got a stranglehold on its neighbor's economy, nor has Moscow attempted to utilize its economic leverage for political purposes. Rather, it is trying to make Afghanistan a showpiece of its policy of non-interference in the affairs of Afro-Asian states.

8. However, Afghanistan both lacks and badly needs convertible exchange. Kabul has been paying local costs for the many Soviet sponsored infrastructure projects, which bring no immediate increase in domestic production, by printing more money. As a result Afghanistan now suffers from a budgetary deficit and growing inflation. Rising demand brought on by these inflationary pressures has led to heavy imports of Western consumer's goods; and to depleted foreign exchange reserves. Most of these imports are paid for by the export of rugs and karakul wool. However, export earnings have sagged because of a decline in Karakul production and to an unrealistic exchange rate which has put much of this trade into illegal channels.

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9. The Afghan government now says it needs more outside aid to get back on its feet and to mend its ways. It now receives about \$20 million in aid, plus PL 480 shipments amounting to \$20 million from the US per year. It is currently requesting: an additional \$30-50 million for the Helmand Valley development project; 150,000 more tons of Title II PL 480 wheat annually for the next six years; and a \$5 million annual commodity loan for the next four years. In return it promises to institute necessary economic reforms, to include at least some devaluation of the currency, reduction of the budgetary deficit, and sharply increased domestic taxation. These reforms, if pushed through, should go far towards getting the Afghans over their present difficulties. Indeed, these measures were previously recommended by the International Monetary Fund (IMF), which is now drawing up a new agreement with the Kabul government. If an agreement is reached, the IMF itself will probably advance a part of the relatively small amounts of exchange needed for the next year or so. However, the Afghans have so far rejected an IMF recommendation for an extensive and needed devaluation of the currency, and prospects for immediate IMF aid are poor.

10. It is doubtful that that the essentially weak and transitional Afghan government will feel that it can immediately

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impose austerity measures on the country. It probably prefers to get further external assistance while continuing its present policies with only slight modifications. However, Kabul so far seems unaware of any new Western reluctance to offer additional assistance, without getting an improved performance in return.* Were further Western aid to be denied -- as appears probable -- anti-American sentiments would be aroused, at least temporarily, and the Soviets would probably offer to provide Kabul with many of the consumer's goods now imported from the West. However, the USSR may be reluctant to satisfy the Afghans need for imported foodstuffs. Most important, the Afghans have shown considerable resistance to Soviet economic encroachment -- in particular, they have refused to divert their Karakul exports -- which provide them with most of their hard currency -- to the USSR. They are not likely to change their minds nor are likely to hurl themselves into the embrace of the Soviets.

* In late April, the Soviets agreed to a moratorium on some debt repayments, and to further project assistance, without quid pro quo's of economic reform.

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II. Political power in Afghanistan remains in the hands of a strong monarchy which can impose needed reforms if they appear necessary. In the long run, it is likely that King Zahir Shah will order such measures. It is too early to say whether they will be made in the context of greater or less state control, and more or less extensive trade ties with the USSR. In any case, Afghanistan is likely to get over its current difficulties brought on by inflation and multilateral exchange shortages, whether or not it receives additional external assistance.

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Ceylon

12. Ceylon also faces serious economic problems. However, the government of Ceylon is also probably less able to impose needed, but unpopular measures on the general public, and its foreign exchange needs are greater than those of Afghanistan. The newly elected, relatively pro-Western Senanayake regime has inherited a situation wherein its leftist predecessor ignored long term development programs. Rather, it used the income from its extensive import earnings and its foreign exchange reserves to pay for increasingly expensive social welfare and food import subsidy schemes. These reserves are now almost exhausted, and the country accordingly suffers from increasing inflation, consumer goods shortages, and unemployment. In the short term, Colombo could either drastically cut back on these subsidy and welfare measures -- an act of political suicide -- or get emergency external assistance as a substitute for its depleted reserves.

13. An IMF representative has tentatively estimated Ceylon's immediate needs at a total of \$50-70 million for the next year in order to maintain price stability and economic activity. The IMF, which is sending a team of experts to make a definitive survey, is prepared to advance up to \$30 million during the next year, and

hopes that Western public and private sources will contribute the remainder. The Ceylon government, not surprisingly, puts its needs much higher -- at some \$72-94 million in commodity and foreign exchange assistance -- for extraordinary food purchases (made necessary by natural disasters) and for replenishing those shortages, e.g., in fertilizer, spare parts and equipment, which now hamper domestic productive capacity. If Ceylon is to receive this aid, the US would have to provide a substantial part of it. Until recently, the US has been restricted by law from giving any aid at all, since Ceylon had not made a satisfactory settlement with those US oil companies whose properties it had nationalized. A mutually satisfactory agreement appears to have been reached, however, and this obstacle has been removed.

14. Both the IMF and the US insist that large scale assistance must be accompanied by major internal reforms: that is, Ceylon's government must, over a period of time, reduce or eliminate its expensive consumer food subsidy schemes. These freed resources should then be diverted to long term, capital producing development programs. However wise such moves might be from an economic standpoint, they would be politically very difficult, since Ceylonese public opinion strongly favors retention of present subsidies -- no matter what the US government and taxpayer think.

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15. On balance, the Senanayake government appears likely to get some initial emergency assistance from the IMF, West Germany, the UK, and some banks and other private investors. If it also receives considerable FL 480 assistance, it can deal with its economic problems for the next six months or a year. However, the odds do not favor its carrying through the reforms -- insisted on by the donors -- to receive continued large scale financial assistance. More likely will be a continuation of recent policies, with Ceylon spending its substantial current foreign exchange earnings (from the sale of rubber, tea and coconuts) on consumption rather than on maintenance, investment, and developmental expenditures. This will be the case even though the Senanayake government itself knows what should be done, and will probably do what it can to bring about needed reforms. It has little room for maneuver, however, and will probably not be able to accomplish much. Barring a sharp rise in commodity prices, we do not expect a dramatic improvement in Ceylon's economic status. However, it is relatively affluent by Asian standards, and can probably continue in this manner for some time without facing an acute crisis.

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Conclusion

16. Afghanistan, Ceylon and India will probably devote considerable energies to acquiring foreign aid in coming years to overcome their economic problems, even though Western resistance to such aid is increasing. Producers and exporters of raw materials, they are vulnerable to shifts in terms of trade, and have little in the way of foreign exchange reserves to fall back on. Further, there is little prospect for improvement in the next few years. Their industrialization programs have not made them economically independent. Their new industries now require large amounts of exchange to purchase spare parts and raw materials needed to keep them functioning. Even when operating at full capacity, these industries will not generally be competitive in Western markets. Prospects for improved export earnings remain poor, and dependence on external resources will continue, and probably will increase.



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